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In the

Supreme Court of the United States

OCTOBER TERM, [redacted] 1970

No. [redacted] 168

AMERICAN NATIONAL BANK OF AUSTIN,
Petitioner,

v.

UNITED STATES OF AMERICA;
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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American National Bank of Austin, petitioner, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on January 19, 1970.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit is reported in 421 F. 2d 442 (5th Cir. 1970). It appears in the Appendix hereto. The opinion of the District Court

for the Western District of Texas, reported in 296 F. Supp. 512 (W. D. Tex. 1968), also appears in the Appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on January 19, 1970. A timely petition for rehearing was denied on February 18, 1970, and this petition for certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether petitioner was the owner of certain municipal bonds and thus entitled to exclude from income under the provisions of section 103 of the Internal Revenue Code the interest received thereon.

STATUTORY PROVISIONS INVOLVED

No statutory provision is directly involved. Indirectly involved is that portion of section 103(a), Internal Revenue Code, which provides:

> "General Rule. — Gross income does not include interest on — (1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia; * * *"

STATEMENT OF THE CASE

Petitioner, herein referred to as taxpayer, is a national banking association. Its municipal bond business began in the late 1930's when many municipalities were recovering from the depression. Many of these municipalities then had outstanding bond issues which they desired to refund. Under the law at that time a municipality could not refund its outstanding bonds unless it refunded an entire issue. Someone had to buy in all bonds in an issue before that issue could be refunded. (R. 19, 77).[1] Taxpayer bought from dealers bonds of an issue which the issuing municipality wanted to refund. It held the bonds it bought until it acquired the entire issue. When the entire issue had been acquired, the bonds were refunded by the municipality with a new issue of bonds. Taxpayer held the refunded bonds subject to a right of repurchase by the selling dealer. (R. 19, 77). Taxpayer entered the business of buying and selling municipal securities without tax thought. (R. 77).

Out of a modest beginning in the refunding business has grown taxpayer's present municipal bond activities in which it buys and sells numerically (not dollar volume) from 50% to 80% of all bond issues floated by political subdivisions of the State of Texas. (R. 18, 19, 36, 37).

When it commenced the bond business (acquiring bonds for refund), taxpayer opened in its general ledger an account styled "Refunding Bonds Purchased". This account

[1] The Transcript of Record is in three volumes. All references are to Volume I unless otherwise indicated.

was and is an asset account and a balance is struck each day showing the book balance of the bonds on hand at the end of the day. Although there is now little refunding, the account still bears the same name and into that account are entered as assets all bonds bought by taxpayer subject to a right of purchase by dealers. (R. 19). The assets represented in this account are investment assets, as opposed to loans, and have been so classified by the national bank examiners. (R. 51, 54).

The first occurrence by an issuing authority with respect to the sale of an issue of municipal bonds in the State of Texas is the publication of the official notice of sale. This notice, among other things, sets forth the amount of the issue, maturity dates, types of bids and interest rates, requirements as to good faith deposit, nature of legal opinion on issue and the place of delivery. Pursuant to this notice bond dealers submit bids to the issuing authority. (R. 19).

In the Texas Bond Reporter, the Municipal Advisory Council of Texas publishes, among other things, official notices of sales. It also indicates the place of delivery of the bonds. With minor exceptions, the bonds are delivered at Austin, Texas, and as a general rule, the bonds are delivered at taxpayer's banking house. (R. 20).

When taxpayer's banking house is designated the place of delivery the first communication to taxpayer with respect to an issue is from the issuing authority. Its letter to taxpayer names the successful bidder and authorizes taxpayer to deliver the bonds to the purchaser against payment

of a specified purchase price. Taxpayer will also receive a letter from the depository bank for the issuing authority respecting transmittal of the proceeds of the sale of the bonds to the bank for the credit of the issuing authority. (R. 20).

After bonds are printed, they are sent to the Attorney General and Comptroller of Public Accounts. In the State of Texas every municipal bond issue has to be examined, certified as to validity, and approved by the Attorney General and has to be registered by the Comptroller of Public Accounts and signed manually by the Comptroller or his authorized representative. (R. 20).

When these requirements are satisfied, the bonds are delivered to taxpayer. At this point taxpayer performs numerous functions on behalf of both the issuing authority and the bond dealer. It examines bonds for printing errors and to determine that the correct number of coupons are attached. The first bond of the issue is sent to the approving attorney who, after examination of the bond, issues an opinion as to the validity of the bond. This opinion is then sent to taxpayer. Taxpayer also receives from a representative of the issuing authority a no-litigation certificate. It also receives, in a fiduciary capacity, an undated receipt for payment of the funds to the issuing authority by the bond dealer. When all required documents are collected and the payment is received, taxpayer transmits the funds to the issuing authority's depository bank and delivers the bonds to the bond dealer in instances where taxpayer has not purchased the bonds. For providing these services taxpayer

receives a handling charge from the bond dealer of twenty-five cents per $1,000 of par value, plus expense incurred (such as insurance, postage and wires). (R. 20).

In instances where taxpayer buys the bonds, the same procedure is followed up to the time of obtaining funds from the bond dealer and transmitting those funds to the depository bank of the issuing authority. Where taxpayer purchases the bonds, the purchase is made pursuant to an authorization by the successful bidder-dealer. No funds are obtained from the bond dealer. Taxpayer sends its own funds to the depository bank of the issuing authority. (R. 21).

Taxpayer acquires entire new issues of bonds and bonds that have already been issued. (R. 21, 39). Taxpayer buys bonds that have already been issued in two ways. A dealer may sell taxpayer bonds out of his inventory. Or taxpayer may purchase bonds which a purchasing dealer has either bought or obligated himself to buy from a selling dealer. Taxpayer estimates that about 90% of the dollar volume of the bonds it purchases are new issues. In all instances taxpayer pays for the bonds, all of which are payable to bearer, with its own funds, takes and retains possession of them and enters them in the account styled "Refunding Bonds Purchased". (R. 21).

Taxpayer has no written agreements setting forth the conditions under which it will buy and sell bonds. The agreement is the same with respect to all dealers. (R. 22, 78). The dealer sells bonds to taxpayer on which he has been the successful bidder or which he has just acquired from another dealer. (R. 22, 37, 78, 144). Or, at the very least

the dealer transfers to taxpayer his right and obligation to buy bonds in the issue or secondary market. (R. 174). In either instance taxpayer pays the purchase price for the bonds to the issuing authority or to the selling dealer with its own funds. The purchasing dealer neither receives funds from taxpayer nor pays funds to the issuing authority or selling dealer, except that where taxpayer buys from a dealer out of his inventory the dealer receives the purchase price from taxpayer. (R. 22). The dealer has a continuing right and option to purchase from taxpayer the bonds he sold to taxpayer. This option remains in effect so long as any of the bonds covered by the option are owned by taxpayer or until the dealer informs taxpayer that he does not desire to purchase any of the bonds then subject to the option. (R. 22, 78, 79, 144, 174, 195, 196).

Taxpayer always buys the bonds at the bid price (or at the price agreed upon by dealers). This is the price which has been set in the market place and is the fair market value of the bonds. (R. 39, 40, 148, 176, 197, 198).

The dealer is in no way obligated to purchase from the taxpayer the bonds which he has an option to purchase. (R. 38, 39, 148, 168, 169, 179, 196). If the dealer elects to purchase the bonds, he is entitled to buy them at book value as reflected on the books of taxpayer plus any accrued interest not reflected on taxpayer's books and plus sales expenses and a handling charge. In practice and in accord with the custom in the industry, the dealer normally buys from taxpayer all bonds on which he has a repurchase right. Taxpayer has never declined to sell to a dealer bonds on

which the dealer had a right of repurchase which he exercised. (By the term "book value" is meant cost of the bonds adjusted upward for interest accrued after date of purchase and reduced by interest collected after that date). (R. 22).

If the dealer fails to exercise his right to repurchase the bonds, taxpayer may sell them to anyone it wishes. If taxpayer sells the bonds to a third party and makes a profit, the profit belongs to taxpayer. If a loss is sustained it must be borne by taxpayer. (R. 38, 80).

Due to the speed with which it must be conducted, most of taxpayer's bond activities are transacted over the telephone. During the years in issue the bond dealer with whom taxpayer dealt, generally by telephone but sometimes by letter, would advise taxpayer that he was the successful bidder or had become obligated to buy bonds and would request and authorize taxpayer to buy the bonds. (R. 23). A dealer did this by informing taxpayer that it had "authority to buy the bonds", or by asking taxpayer to "take up" the bonds, or "take up the bonds for our account", or "take up and advise". Under the understanding between dealers and taxpayer, this meant that the dealer was asking and authorizing taxpayer to buy the bonds under the option arrangement between them (R. 40, 41, 79, 145, 146).

On each purchase taxpayer sends a notice to the successful bidder or purchasing dealer that "the following securities were purchased today". The notice lists the name of the security, its par value, the date of issue, the seller, the amount, denomination, interest rates, maturity, numbers of the bonds, first and subsequent coupon dates, Comptrol-

ler's registry number, paying agent, name of counsel and total purchase price inclusive of accrued interest. (R. 23).

When taxpayer transmits its cashiers check in payment of the purchase price for bonds, its Bond Department sends a charge memo to its cashier showing a memorandum charge in the amount of the purchase price to the Refunding Bond Account. Pursuant to this memo a charge is made to that account so that taxpayer's general ledger reflects at the end of each day the book balance of municipal bonds held by taxpayer. (R. 24).

Taxpayer maintains a subsidiary ledger with respect to municipal bonds. It sets up a separate ledger sheet for each purchase. On this sheet there are initially entered the name of issuer, the date of issue, the name of the dealer, the nature of the bonds, the rate or rates of interest, maturity dates, first coupon date, subsequent coupon dates, par value of bonds and cost of bonds. As sales of bonds are made they are entered on this ledger sheet. Such entries show the par value of the bonds sold, the dealer's sales price, the par balance remaining and the book balance remaining. Also as sales are made taxpayer's Bond Department sends a credit memo reflecting the dealer's sales to its Cashier so that the sale of the bonds can be reflected in the Refunding Bond Account in its general ledger. (R. 24).

Each month interest is accrued through the twenty-fifth of the month. The only interest accrued or received by taxpayer is coupon interest at the coupon rate. A debit memo is prepared showing the interest earned on each issue for that month. On the subsidiary ledger sheet the

monthly interest accruals are entered as a book debit and accordingly increase the book balance. When coupons become due taxpayer clips them and collects and keeps the coupon interest. On the subsidiary ledger sheet the collections on the coupons are entered as a book credit and accordingly decrease book balance. The monthly accruals of interest are credited to an account entitled exempt interest earned on taxpayer's general ledger. (R. 24).

When a dealer desires to purchase bonds from taxpayer he so advises taxpayer. The bonds are repurchased by a dealer as he finds customers for the bonds. Such repurchases may occur as to all or any part of the issue held subject to the right of repurchase. The dealer sells the bonds and sends to taxpayer an invoice made out to its customer. Taxpayer sends this invoice and the bonds to the bank at which they are to be paid for under instructions that such bank deliver the bonds to a designated purchaser against payment of the dealer's invoice price and that such bank remit (or credit) the purchase price to taxpayer. Under taxpayer's instructions to the collecting bank, interest on the bonds is accrued only to the date the sale and purchase is closed. In many instances funds are in transit to taxpayer for two or three days. (R. 25). (Bank loans bear interest until current funds are received.) (R. 43, 44).

On every sale taxpayer sends to the dealer an invoice. This invoice shows the bank to which the securities are sent, the name of the issue, the name of the purchaser (from the dealer), the payment date, daily additions for interest,

the selling price, and the person (dealer) to whom taxpayer sold the bonds being sold. (R. 26, 86).

On each sale of bonds by a dealer, the sales price is paid over to taxpayer and this sales price is entered as a book credit which goes to reduce book balance. Final settlement with reference to sales from taxpayer to dealer is not normally made until all bonds in the issue have been sold. Taxpayer charges the dealer with the expenses of sale—insurance, postage and wires. On the sale it also charges the dealer with the handling charge of twenty-five cents per $1,000 of par value. This is the price on which the final settlement of all sales is made. (R. 26).

When all the bonds of an issue have been sold, a closing statement is prepared by taxpayer and furnished to the dealer. This statement is to the dealer. It reflects final settlement between taxpayer and the dealer. As to the dealer it shows gross profit or gross loss and charges for postage, insurance, wire and premium, together with interest accrued on the bonds since the last monthly accrual or since bonds were bought by the bank in case they were not owned by it on the monthly accrual date. It then shows the balance due either the dealer or taxpayer. If a balance is due the dealer, taxpayer (at dealer's election) either remits same to him or credits it to his account with taxpayer. The statement is a bill to the dealer in case there is a balance due taxpayer. The dealer remits such balance to taxpayer or, if he has an account with taxpayer, may authorize taxpayer to debit his account with such balance. (R. 26, 43).

During the years in issue dealers would exercise their rights to purchase by writing taxpayer, sending to taxpayer invoices to their customers. In some instances, dealers would write taxpayer stating, for example, that taxpayer held designated bonds "for our account" or "subject to our instruction", enclosing invoices of sale to the dealers' customers and setting forth shipping instructions. (R. 27, 42, 85). Under the understanding between the dealers and taxpayer this meant that the dealer had exercised its option to purchase the bonds covered by the invoices. (R. 42, 85, 146).

Generally a dealer will offer bonds for sale both before and after taxpayer holds the bonds subject to his right of repurchase. When a dealer bids in or is awarded an issue he commences to sell bonds for future delivery and ordinarily he has sold a substantial portion of the issue before the bonds are issued. On the issuance of the bonds all of them are purchased by taxpayer and the dealer exercises his right of repurchase as to all bonds sold on or before the issue date. Dealers customarily offer for sale in two ways bonds held by taxpayer subject to rights of repurchase. One method utilized by dealers to offer such bonds is to list them in "The Blue List of Current Muncipal Offerings". Another method used by dealers is to prepare and mail to prospective customers offering circulars on the bonds. Dealers also customarily prepare and mail offering circulars before bonds have been issued in instances where they have bid in or been awarded an issue. As a general rule the bonds taxpayer purchases subject to a right of repurchase are not held by taxpayer for more than 30 days. (R. 25, 30).

While the dealers normally buy bonds from taxpayer at their agreed purchase price when they know they will sell the bonds for less, they know that they do not have a legal obligation to purchase. (R. 148, 169, 179, 196). They buy them because they think such is good business. They want taxpayer to continue to trade in municipals. (R. 44, 45, 147, 196, 197).

During the years in issue, no dealer informed taxpayer that it was not going to exercise an option. In prior years two dealers informed taxpayer they did not intend to exercise their option. One of these dealers had options on bonds in a single issue. The other dealer had options on approximately 34 issues. The option price with respect to 23 of these issues was substantially above the then market value of the bonds. The option price with respect to the other issues was below the then market value. The particular dealer exercised his options on the bonds with a profit, but failed to exercise the options on the 23 issues where the option price was above market value. Taxpayer, upon hearing that this dealer was planning to discontinue the municipal bond department of his business contacted the dealer to determine whether he wished to exercise his option to purchase the remaining issues. Taxpayer was informed that the dealer would not exercise the option, thereby releasing the right or option to repurchase. Taxpayer eventually sold these bonds in the market at a loss which was borne by taxpayer. Taxpayer made no effort to force the dealer to repurchase these loss bonds or to make up the loss, even though the dealer was adequately solvent.

Taxpayer recognized that the dealer had absolutely no obligation to repurchase the bonds and was informed by its attorney that because of such the dealer was in no way liable to taxpayer. (R. 79, 80, 94-103, 123, 124).

Taxpayer carries as assets which are reflected in its financial reports and call statements the bonds entered in its Refunding Bond Account. (R. 17). It also carries as assets which are reflected in its financial reports and call statements its long term bond investments which are entered in an account on its general ledger entitled "Other Bonds & Securities". (R. 49, 50, Stip. Exhs. 4, 5, 6). Dealers do not treat the bonds owned by taxpayer as assets on their financial statements nor do they reflect any obligation to taxpayer on such statements. (R. 147, 158, 159, 175).

Taxpayer both at time of acquisition and subsequent thereto sold bonds to other banks. The purchasing banks honored the arrangement taxpayer had made with dealers. (R. 27).

Taxpayer sells bonds only to other banks and to dealers. It does not employ bond salesmen. It does not sell to the public. It cannot sell to the public because it does not have a securities license. Although taxpayer can bid on new issues, it submits no bids to political subdivisions. (R. 21).

Taxpayer will buy issues that dealers have successfully bid in, and bonds from dealers, only if it is satisfied with the credit of the issuing authority. While taxpayer from time to time receives voluntarily and without request financial statements from some dealers, as most banks do, it

purchases the municipals without reference to the credit of the dealer and makes no credit investigation of dealers. (R. 44, 81, 83, 84).

During the years in issue taxpayer's statutory loan limit was $450,000 until March of 1964, at which time it was increased to approximately $610,000. In numerous instances taxpayer owned bonds, subject to a particular dealer's option to purchase, on which the aggregate option price would range from 10 to 20 times the loan limit of a loan to the dealer. (R. 45).

Taxpayer may not, under regulations of the Comptroller of the Currency, and in fact does not, make loans unless they are evidenced by a note or some kind of debt instrument. When taxpayer does make a loan and takes collateral for the loan, the borrower, in addition to signing a note must sign a collateral pledge lien. (R. 36). When taxpayer purchases bonds and gives the dealer a right to purchase bonds, the dealer does not execute a note or any other kind of debt instrument. (R. 28).

The trading by taxpayer in municipals during the years in question has been subjected to the scrutiny of the Comptroller of the Currency. He has approved taxpayer's method of doing business. Bank examiners have classified taxpayer's account styled "Refunding Bonds Purchased" as an investment account and have classified the municipal bonds it owns subject to the right of a dealer to repurchase as an investment of taxpayer, as opposed to a loan. They refer to taxpayer's "Refunding Bonds Purchased" account

as its trading account. During the years in question, in a report of examination by the Comptroller of Currency, it was stated in respect to these bonds, that "Such bonds are purchased for the high tax-exempt income." and that taxpayer "has an active business with bond dealers from whom such bonds are purchased. The bank's trading account is active and handled with informed judgment." (R. 51-54, 129, 130).

During the years in question, the average rate of interest taxpayer received on loans was approximately 6%. During those years the average rate of interest paid on municipal bonds was approximately 3.50% to 3.75% (R. 46, 47, 82).

During the years in issue as a consequence of exercises by bond dealers of their rights of repurchase, taxpayer and bond dealers made final settlement with reference to 4500 separate and distinct purchases of bonds by taxpayer from bond dealers. (R. 152).

The district court specifically found, in addition to the stipulated facts, the following facts:

1. Under the agreement between the taxpayer and the dealers the dealer was not obligated to buy the bonds, but merely had an option to buy them. In the event the dealer did not exercise his option, the taxpayer could sell to anyone and the taxpayer was to absorb any gain or loss on the sale. (R. 206, 215).

2. The taxpayer purchased the bonds at their market value. (R. 207, 212, 214).

3. There was no tacit obligation to repurchase. A dealer could exercise his option at his discretion and taxpayer could not have forced the dealer to buy the bonds. (R. 211).

4. The fact that a dealer normally exercised his option was not the result of a legal obligation, but the result of sound business judgment. (R. 211).

5. Taxpayer entered the bond business to make money and not to evade taxes, convert ordinary income into exempt income, or circumvent loan restrictions. (R. 211, 214).

6. The language used between taxpayer and dealers when a dealer wished the taxpayer to buy bonds under the arrangement was trade language and was commonly understood to mean that the dealer asked the taxpayer to purchase the bonds subject to the dealer's right to repurchase. (R. 212, 213).

7. The bonds were not part of the inventory of the dealers, nor were they carried on their records as inventory. (R. 213, 215).

8. Taxpayer and each dealer at all times treated the securities, the coupons and the interest received as property of the taxpayer. (R. 215).

9. In making loans, taxpayer almost always required that the borrower maintain with it a banking relationship and the borrower was normally required to maintain a compensating balance of at least 10% of the loan. Taxpayer bought bonds from and sold bonds to dealers without reference to

any banking relationship and without any request or requirement therefor. (R. 215).

The district court determined that taxpayer was the owner of the bonds in question and that the interest received thereon was tax exempt to it. Judgment was entered in favor of taxpayer and respondent was ordered to refund the sum of $788,382.44, plus interest. The Fifth Circuit reversed the judgment of the district court. It, reviewing the case de novo, determined that the taxpayer's "ownership" of the bonds was without substance and that therefore taxpayer was not entitled to treat the bond interest as tax exempt income.

REASONS FOR GRANTING THE WRIT

1. *The Decision Below Conflicts With the Decision of Another Court of Appeals.*

The issue presented in this case has been before three other courts of appeal. *First National Bank in Wichita v. Commissioner*, 57 F. 2d 7 (10th Cir. 1932) *cert. denied*, 287 U.S. 636, *aff'g.* 19 BTA 744 (1930); *Commissioner v. The Bank of California, National Association*, 80 F. 2d 389 (9th Cir. 1935), *aff'g.* 30 BTA 566 (1934); and *Union Planters National Bank of Memphis v. United States*, F. 2d (6th Cir. 1970), decided May 4, 1970. In *Bank of California* the court held that the taxpayer-bank owned the bonds. In the other two cases the courts held that the banks had made loans on the security of the bonds and that the dealers owned them.

As demonstrated in the following chronological consideration of the cases the decision of the Fifth Circuit in this case and the decision of the Sixth Circuit in the *Union Planters* case is in conflict with *Bank of California* and the rule of law on which the decision of the Board of Tax Appeals and the Tenth Circuit in *First National Bank in Wichita* was predicated.

In *First National Bank in Wichita* the bank advanced to customers the face or par value of securities which were assigned to the bank, without any regard to their market value. Under a repurchase agreement the customer had the privilege of repurchasing the securties at their original purchase price. In the event the customer failed to exercise this privilege the bank could sell the securities in the market. Any loss incurred on such a sale was made up by the customer. Also, any gain so derived went to the customer. The interest agreed upon by the parties was the current loan rate, without regard to the coupon rate. In the majority of instances the rate of interest charged was less than the coupon rate. Coupons attached to securities were considered by the parties as owned by the customer, and when interest became due the coupon was clipped by the bank and actually delivered to the customer so that the customer could collect the interest. The customer paid interest due the bank regularly on a monthly basis, without regard to the time the coupons became due. The customer treated the amount of interest received from the securities as its own tax exempt income. The bank treated the amount of interest received from the customer as tax exempt income, without regard

to the actual amount of coupon interest. The arrangement between the bank and its customers was designed to enable it to supply its customers with money in amounts in excess of the legal loan limits.

The Board of Tax Appeals stated that the question to be decided was not one of legal title but rather who, under the understanding between the bank and its customers, was entitled to receive the coupon interest. The Board and the Tenth Circuit found that the true relationship between the bank and is customers was that of a lender of money in consideration for the legal rate of interest payable on the amount advanced.

In *Bank of California* the bank acquired tax exempt securities from investment dealers and at the same time entered into repurchase agreements with them. The agreements provided that the dealer was obligated to repurchase the securities upon tender by the bank. In the event of failure to pay at time of tender, the bank could sell the securities in the market. The dealer was obligated to make up any loss incurred by the bank on such sale. The bank kept as its own any profit. The purchase price was based on, but usually under, the market value of the securities (plus accrued interest) and the repurchase price was the same as the purchase price. Also, the interest rate was the coupon rate, and when a coupon became due, it was collected by the bank for its own account.

The Board of Tax Appeals cited with approval its earlier decision in *First National Bank in Wichita*. It decided that

the taxpayer-bank owned the bonds and that the interest it received was tax exempt. In so holding, the Board reasoned that the only interest that the bank received was coupon interest at the coupon rate and that the right of the bank to retain as its own any profit realized on a sale of bonds to a third party was incompatible with a loan. The Ninth Circuit affirmed as there was substantial evidence that the bonds belonged to the taxpayer-bank. In this case, as in *Bank of California*, the only interest taxpayer was entitled to was coupon interest and taxpayer was entitled to any gain realized on a sale by it of bonds not purchased by the optionee-dealer. Moreover, the taxpayer, as distinguished from the California taxpayer-bank, bore the risk of loss if the optionee-dealer did not purchase the bonds. Thus, this case is more compelling for the taxpayer than *Bank of California.*

In *Union Planters* the taxpayer-bank bought the bonds from dealers under a repurchase agreement obligating the dealers to repurchase the bonds. If they did not repurchase them they were charged with any loss. While the opinion is not explicit as to the rights of the parties as to any profit realized on a sale to a third party by the bank, there were three instances in which the bank retained the profit. The only interest collected by the bank in *Union Planters* was coupon interest. It will thus be seen that there is a clear conflict between *Bank of California* and *Union Planters.*

2. *The Decision Below Disregards the Principle of Federal Income Taxation That an Unconditional Debt Is a Prerequisite To a Debtor-Creditor Relationship.*

The Fifth Circuit found the taxpayer a lender, even though there was no indebtedness to the taxpayer by a dealer. The existence of a debt is essential to a debtor-creditor relationship. A debt arises only from an unconditional obligation to pay. The classic rule laid down in *Gilman v. Commissioner*, 53 F. 2d 47 (8th Cir. 1931) is:

> "Every debt * * * must be certain and in all events payable; whenever it is uncertain whether anything will ever be demandable by virtue of a contract, it cannot be called a 'debt' * * * * The term 'indebtedness' as used in the Revenue Act implies an unconditional obligation to pay. Any definition more favorable would only encourage subterfuge and deception."

The district court in this case found that the dealers were not obligated to repurchase the bonds. The Fifth Circuit also found that dealers were not obligated to take up the bonds when it found that the taxpayer ran the risk that a dealer would be indifferent to the consequences of not taking the bonds. In other words, the Fifth Circuit recognized that the taxpayer could not compel the dealers to take the bonds. Thus it made the dealer a paradoxical debtor without any obligation to pay. As such, the decision conflicts with other decisions of the Fifth Circuit and other courts of appeal in *United States v. Virgin*, 230 F. 2d 880 (5th Cir. 1956), *Commissioner v. Park*, 113 F. 2d 352 (3rd Cir. 1940), *Burton v. Bowers*, 172 F. 2d 429 (4th Cir. 1949), and *Thompson v. Commissioner*, 235 F. 2d 599 (9th Cir. 1956).

3. *The Decision Below Disregards Rule 52(a) of the Federal Rules of Civil Procedure.*

Rule 52(a) of the Federal Rules of Civil Procedure provides that "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses". The Fifth Circuit endeavored to avoid any confrontation with this rule by stating that the basic facts in this case were stipulated or otherwise undisputed. Upon such determination the Fifth Circuit proceeded with a de novo review of the case. When a case consumes two days of lengthy testimony, and direct testimony of witnesses is controverted time and again by opposing counsel, it is difficult to accept such conclusions by an appellate court.

This Court has said that ownership is a question of fact. *Helvering v. Clifford*, 309 U.S. 331 (1940). The exact issue under consideration was said to be a question of fact by the Ninth and Tenth Circuits. *Commissioner v. Bank of California, supra; First National Bank in Wichita v. Commissioner, supra.* Since it is a question of fact, it is subject to the clearly erroneous rule. *Commissioner v. Duberstein*, 363 U.S. 278 (1960).

The district court found the facts in favor of the taxpayer. The findings by the district court were fully substantiated and its ultimate conclusions clearly followed from those findings. Those findings should not have been reversed.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,

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APPENDIX A

1. Opinion — Fifth Circuit

In the

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 27301

AMERICAN NATIONAL BANK OF AUSTIN,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Western District of Texas

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(January 19, 1970)

Before GEWIN, THORNBERRY and AINSWORTH, Circuit Judges.

AINSWORTH, Circuit Judge: The issue presented in this case is whether certain transactions of taxpayer, a national bank, with various municipal bond dealers during the years 1962-1964 are correctly characterized as sale-repurchase

transactions, as the District Court concluded,[1] or whether they should be held to be secured-loan transactions for tax purposes, as the Government contends. If they were sale-repurchase transactions, the municipal bond interest collected by taxpayer during the years 1962-1964 should have been excluded from taxpayer's gross income as interest received on state governmental obligations owned by taxpayer. Int. Rev. Code of 1954, § 103(a) (1). On the other hand, if they were secured-loan transactions, this interest should have been included in taxpayer's gross income as taxable income realized by taxpayer from bond dealers for advancing funds on their behalf. Int. Rev. Code of 1954, § 61(a) (4).

This is a tax refund suit brought by taxpayer, the American National Bank of Austin, against the United States to recover income taxes and interest assessed against it and collected by the Commissioner of Internal Revenue in the amount of $788,031.77 for the taxable years 1962, 1963, and 1964. After a nonjury trial at which oral testimony and exhibits were received, together with a stipulation of facts and attached exhibits, the District Court agreed with taxpayer's contentions and ordered the refund. From this judgment the Government appeals.

During the years 1962-1964 taxpayer received income in the form of interest it collected or accrued on municipal bonds[2] while these bonds were in its possession. In its

[1] American National Bank of Austin v. United States, W. D. Tex., 1968, 296 F. Supp. 512, 518.

[2] As used here, the term "municipal bonds" refers to all types of state, county, and municipal obligations in which taxpayer dealt in the transactions here in issue.

income tax returns for these years taxpayer excluded this interest from its gross income and computed its tax liability in reliance upon section 103(a) (1) of the Internal Revenue Code of 1954, which provides that a taxpayer's gross income does not include interest on municipal bonds.[3] The Commissioner determined that taxpayer was not entitled to the section 103(a) (1) income exclusion on the ground that taxpayer never acquired ownership of the bonds. Accordingly, he found deficiencies in taxpayer's reported tax liability for the years here in issue. Taxpayer paid the deficiencies and made refund claims asserting that the Commissioner's determination was erroneous. This suit followed the Commissioner's disallowance of taxpayer's claims.

Since sale-versus-loan cases turn upon their own particular facts, *United States v. Ivey*, 5 Cir., 1969, 414 F. 2d 199, the decided cases[4] which have considered the precise question presented here offer little directional guidance toward a proper resolution of this case. We therefore take the route of ad hoc exploration through an expanse of essentially

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[3] Section 103 of the Internal Revenue Code of 1954 reads in pertinent part as follows:

"(a) General rule. — Gross income does not include interest on —

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia; * * *"

[4] Commissioner v. Bank of California, Etc., 9 Cir., 1935, 80 F. 2d 389, *aff'g* B.T.A., 1934, 30 B.T.A. 556; Commissioner v. Wells Fargo Bank & Union Trust Co., 9 Cir., 1935, 80 F. 2d 390; First Nat'l Bank in Wichita v. Commissioner, 10 Cir., 1932, 57 F. 2d 7, *aff'g* B.T.A., 1930, B.T.A. 744; Union Planters National Bank of Memphis v. United States, W. D. Tenn., 1968, 295 F. Supp. 1151. An appeal by the Government in *Union Planters* is pending before the Sixth Circuit.

undisputed facts, *see United States v. Winthrop*, 5 Cir., 1969, F. 2d [No. 26176, October 22], to find that taxpayer was not entitled to the section 103(a) (1) income exclusion. The judgment appealed from must therefore be reversed.

I.

Taxpayer is a national banking association. Its banking house is located in Austin, the state capital of Texas, where practically all bond issues floated by political subdivisions of that state are examined, certified, and executed. Taxpayer's business in connection with municipal bonds began in the late 1930's when many Texas municipalities had bond issues outstanding which they desired to refund with new issues. Under then existing law, these municipalities could not refund issues piecemeal, but had to refund entire issues at one time. As a condition precedent to refunding, someone, a single concern or syndicate, had to acquire all the bonds in an issue.

When taxpayer began obtaining bonds to be refunded, it opened in its general ledger an account styled "Refunding Bonds Purchased." Taxpayer maintains this account as an asset account in which a balance is struck daily showing the book balance of bonds on hand at the close of the busi-

The parties prepared an extensive stipulation of facts subject to the following proviso: "The use of the words 'purchase', 'buy', 'bought', 'sell', 'sale' and 'sold' and words of similar import in this stipulation with reference to the transactions whereby [taxpayer] obtained possession of municipal bonds subject to a repurchase right in dealers or whereby other banks acquired bonds from [taxpayer] shall not be deemed an admission by [the Government] that an absolute sale occurred." In summarizing the facts here, we have attempted to avoid the use of words of such conclusory import.

ness day. Although taxpayer now engages in few transactions involving refunding, the account retains its original name, and into it are entered as assets all bonds that have come into taxpayer's possession as a result of the transactions here in issue.[6] Aided by its location, taxpayer has vigorously pursued its municipal bond activity and now engages in transactions involving from 50 to 80 per cent of all bonds issued by Texas political subdivisions. During the years 1962-1964 taxpayer concluded with bond dealers approximately 4500 transactions involving issues of municipal bonds in bearer form. Approximately 90 per cent, by dollar volume, of taxpayer's bond transactions involve new issues. The remainder of its transactions involve transfers from dealers rather than from issuing authorities.[7]

The distribution of a new issue of municipal bonds in Texas is commenced by the issuing authority when it publishes the official notice of sale. Such a notice generally will include statements of the amount of the issue to be floated, types of bids and interest rates, requirements re-

[6] The record shows that taxpayer's holdings of municipal bonds were grouped in three categories. On December 31, 1963, for example, taxpayer held $14,664,501.36 worth of municipal bonds that were the subject matter of the transactions here in issue. Taxpayer's annual report for 1963 shows $16,583,244.13 debited to the asset account styled "State, County and Municipal Obligations." The difference between these two amounts — $1,918,742.77 — was apparently owned by taxpayer free of any so-called repurchase option. The 1963 report also shows an asset account styled "Other Bonds and Securities," in which $174,250.00 is debited. Taxpayer purchased the last-mentioned bonds to obtain the coupon-paying agency of their issuers.

[7] For tax purposes we see no distinction between taxpayer's activities in the new-issue and secondary bond markets. Accordingly, for the sake of simplicity we here concentrate on taxpayer's dealings in new issues. The legal consequences of both kinds of activity are the same.

garding a good-faith deposit by the successful bidder, and the place designated for delivery of the bonds. As a general rule, bonds are made deliverable to taxpayer's banking house. If taxpayer's banking house is so designated, taxpayer first becomes involved in the distribution of an issue when the issuing authority notifies it of the successful bidder and authorizes it to deliver the bonds to the purchaser against payment of the specified bid price. The depositary bank of the issuing authority then advises taxpayer regarding transmittal to the depositary of the proceeds derived from the bond flotation. The bonds, following their approval and certification by the appropriate state officers, are then delivered to taxpayer. Upon receiving the bonds, taxpayer performs numerous functions on behalf of the issuing authority and the successful bidder-dealer. For example, it examines the bonds for printing errors, determines whether the correct number of coupons have been attached, obtains an opinion letter on the validity of the issue, and receives an undated receipt for payment of the purchase price to the issuing authority by the bond dealer.

Taxpayer concluded its new-issue transactions with bond dealers in either one of two ways during the years in issue. First, the successful bidder might pay taxpayer the purchase price of the bonds for transmittal to the depositary bank of the issuing authority. In this situation taxpayer would simply transmit the payment to the depositary and deliver the bonds to the dealer or at the dealer's order. For its services taxpayer would receive from the dealer a

handling charge of 25c per $1,000 of par value and reimbursement for the expenses, such as insurance, postage, and wires, it had incurred.[1] Secondly, the successful bidder and taxpayer might agree that taxpayer's funds, rather than the bidder's funds, would be transmitted to the depositary of the issuing authority in payment of the purchase price bid by the dealer.

During the years 1962-1964 dealers occasionally wrote to taxpayer to request that taxpayer "make payment" to the issuing authority for bonds the dealers had been awarded and "accept delivery for our account" or "take [the bonds] up for our account." Usually, however, communications between the parties were by telephone. Taxpayer and the dealers made no written agreements regarding their various rights and obligations with respect to new issues. All these agreements, however, were the same.

Upon receiving the successful bidder's notification, taxpayer, if satisfied with the credit rating of the issuing authority, would pay with its own funds the full bid price to the authority and retain the bearer bonds in its possession. Taxpayer normally would agree to such arrangements with dealers if the issue was rated "BAA" or higher. Relying upon this rating, taxpayer would make no credit investigation of the dealer obligated to buy the bonds.[2] The dealer would transmit no payment to the issuing authority, receive no payment from taxpayer, and execute no debt instrument

[1] Transactions of this type are not in issue here.

[2] Taxpayer occasionally would receive unsolicited credit reports on dealers, but made no attempt to obtain such reports.

of any kind.[10] After paying the issuing authority, taxpayer would send to the successful bidder a form notice captioned "The following securities were purchased today," which fully identified the purchased bonds.

Generally the official notice of sale would provide for a good-faith deposit by the successful bidder. At one time the notice normally specified that this deposit would be applied against the purchase price of the issue. During the years 1962-1964, however, the issuing authority in approximately 90 per cent of the new-issue transactions in which taxpayer was involved returned the successful bidder's deposit to the bidder upon receipt of payment from taxpayer. In approximately 9 per cent of these transactions the issuing authority sent the bidder's check to taxpayer. In approximately 1 per cent of the transactions the issuing authority negotiated the bidder's check in partial payment of the purchase price. When the issuing authority either sent the check to taxpayer or negotiated it, taxpayer made the dealer whole.

Taxpayer does not employ bond salesmen or sell bonds to the public. It cannot legally sell bonds to the public

[10] At trial taxpayer's president testified that all the bank's loans are evidenced by some kind of debt instrument. He recalled no loan taxpayer made to a dealer during the relevant years which was secured by municipal bonds. He recalled only one loan made to a dealer for the purpose of providing him funds with which to acquire municipals. Taxpayer's statutory loan limit was $450,000 until March 1964, at which time it was increased to approximately $610,000. Aside from the transactions here in issue, taxpayer, with infrequent exceptions, did not during the years 1962-1964 make advances to or on behalf of anyone that did not maintain a banking relationship with it. Such a borrower was normally required to maintain a compensating balance — generally equaling at least 10 per cent of the loan. Taxpayer would require a compensating balance for the purpose of maintaining sufficient liquidity rather than as a safety measure.

because it does not have a securities license. Although taxpayer legally may bid for new issues, it does not. Throughout the history of taxpayer's business in connection with new-issue bonds, the bonds for which taxpayer paid the original purchase price were offered and sold to the public by the dealers who had successfully bid for them. These dealers offered bonds for sale to their customers both before and after taxpayer had made payment for them to the issuing authority. When a dealer was awarded an issue, he would begin selling bonds immediately for future delivery. Ordinarily a substantial portion of an issue would be sold before the bonds were actually issued and before taxpayer had paid the issuing authority for them. Dealers would offer bonds for sale in two ways. First, they would list the bonds in *The Blue List of Current Municipal Offerings*. Secondly, they would mail offering circulars to prospective customers. These circulars were customarily prepared and mailed before the bonds were issued.

Taxpayer would retain bonds in its possession until the bidder-dealer effected their disposition to its customers. During this period, usually no longer than thirty days, taxpayer accrued the interest income on the bonds at the coupon rate and credited the interest to a general account styled "Exempt Interest Earned." Taxpayer's accounting procedures reflected its possession of the bonds and accrual of interest on the bonds as follows. When taxpayer transmitted to the issuing authority's depositary its cashier's check in payment for an issue, taxpayer's Bond Department would send a charge memo to its cashier which showed a

memorandum charge in the amount of the purchase price to the "Refunding Bonds Purchased" account in taxpayer's general ledger. Taxpayer further maintained a subsidiary ledger sheet pertaining to each bond issue. On such a sheet taxpayer would initially enter the name of the issuer, the name of the successful bidder-dealer, the nature of the bonds, the rate or rates of interest, maturity dates, the first and subsequent coupon dates, and the par value and purchase price of the bonds. As the dealer sold bonds in the issue to the public, its sales would be individually shown on the subsidiary ledger sheet by entries recording the par value of the bonds sold, the dealer's sale price, the par balance remaining, and the book balance remaining. Similar entries recording each sale would be made in the general account. The interest that taxpayer accrued on the bonds would be entered as a debit in the subsidiary ledger, thus increasing the book balance. When coupons were clipped, the collections made thereon would be entered as a credit in the subsidiary ledger, thus decreasing the book balance.

As a dealer found customers for the bonds for which it had bid, it would prepare an invoice made out to the customer and send this invoice to taxpayer. Taxpayer would then send the invoice and the bonds purchased by the customer to the bank at which the customer was to tender payment. It would also instruct the collecting bank to deliver the bonds to the designated purchaser against payment of the dealer's invoice price and to remit or credit the purchase price to taxpayer. Under taxpayer's instruc-

tions, interest on bonds was accrued only until the date the sale and purchase was closed. As a result, taxpayer would accrue interest on bonds committed by the dealer for future sale only during the period (a few days) required for completion of the paper work precedent to actual disposition of the bonds. Taxpayer would not accrue interest while the customer's funds were in transit from the collecting bank to taxpayer. With respect to bonds not sold until after the date of their issuance, taxpayer would accrue interest from the date of issuance until disposition of the bonds by the dealer was affected.

With respect to every sale by a dealer to the public of bonds for which the dealer had bid and taxpayer had paid the issuing authority, taxpayer would send the dealer an invoice showing the bank to which the bonds were sent, the name of the issue, the name of the dealer's customer, the payment date, daily additions for interest, the selling price to the customer, and the name of the dealer. After the customer's payment was transmitted to taxpayer from the collecting bank, taxpayer would enter this payment as a credit reducing the book balance of the particular issue in its subsidiary and general ledgers.

When all the bonds of an issue had been sold by a dealer to its customers, a closing statement would be prepared by taxpayer and furnished to the dealer which reflected the final settlement between them. This statement would show the dealer's gross profit or loss on the issue and include taxpayer's specific charges for insurance, handling, postage, and wires, together with the interest accrued since the last

monthly accrual date, or since the date of issuance if that was subsequent to the last monthly accrual date. Finally, the statement would show a balance due either the dealer or taxpayer. When a balance was due the dealer, taxpayer, at the dealer's election, would either remit it to the dealer or credit it to the dealer's account with taxpayer, if there was one. When a balance was due taxpayer, the statement would serve as a bill to the dealer.

Computation of the balance due either the dealer or taxpayer was made as follows. To taxpayer the dealer would owe an amount equal to the sum of (1) the book value of the bonds, (2) the accrued interest not reflected on taxpayer's books, (3) taxpayer's handling charge, and (4) taxpayer's wires, postage, and insurance expenses. The term "book value," as used here, means the bid price of the bonds adjusted upward for the interest accrued after the date of issuance and reduced by the interest actually collected by taxpayer. Thus the amount due taxpayer was computable without regard to the relative success or failure of the bond flotation. Taxpayer would owe the dealer the sum of the payments transmitted by the dealer's customers in return for the bonds. This sum depended entirely upon the public's demand for the bonds. Whether a balance would be due the dealer or taxpayer would also depend entirely upon the price at which the dealer could sell these bonds to the public. The closing statement, therefore, reflected the dealer's degree of success or failure in disposing of bonds for more than the fixed amount it would pay taxpayer.

Throughout the history of taxpayer's business with dealers in connection with new-issue bonds for which the dealers had bid and taxpayer had paid the issuing authority, taxpayer never refused to transfer bonds at the direction of the bidding dealer once the dealer caused taxpayer to be paid the book value of the bonds and taxpayer's handling charge and sales expenses. During the years 1962-1964 no dealer who had successfully bid on bonds for which taxpayer paid the bid price to the issuing authority failed to protect taxpayer against the risk that the bonds could not be sold to the public for at least the value assigned them on taxpayer's books. Indeed, only twice in the history of taxpayer has a dealer failed to cause taxpayer to be paid the book value of bonds for which taxpayer had paid, together with taxpayer's handling charge and incidental expenses.

During the years 1962-1964 taxpayer occasionally arranged for the participation of two other Texas banks in paying to an issuing authority the purchase price of bonds for which a dealer had successfully bid. These banks would either credit taxpayer's accounts with them or remit the price to taxpayer, who would then pay the entire bid price to the issuing authority. Taxpayer would retain in its possession the bonds paid for by the other banks and issue a safekeeping receipt to the other bank or banks participating in the transaction. Such a receipt would show the name of the issue, the interest rate, the maturity date, and the specific bond numbers of the bonds for which the other participating banks advanced payment. As the dealer who had bid for the

issue found customers for the bonds covered by the safekeeping receipt, these banks would send an invoice to the dealer, charge taxpayer's account on their books in the amount of the book value of the bonds sold, and instruct taxpayer to deliver the bonds at the dealer's instruction. Like taxpayer, these banks always followed the instructions of the dealer having a customer for bonds for which they had paid the issuing authority.[11]

Since taxpayer is a national banking association, its municipal bond transactions during the years 1962-1964 were subjected to the scrutiny of the Comptroller of the Currency.[12] For years both the Comptroller and the Federal Reserve System Board of Governors had agreed that a transaction in which a bank bought securities under an agreement to resell constituted, for banking regulation purposes, a loan by the bank and a borrowing by the "seller."[13] In 1963, however, the Comptroller reversed direction and ruled[14] that such a transaction did not constitute a loan transaction subjecting a "purchasing" bank to statutory lending limitations[15] and

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[11] During the years 1962-1964 the only bonds a national bank could sell subject to a repurchase agreement to another bank were federal government bonds. The banks dealing with taxpayer, however, always honored taxpayer's agreements with the bond dealers.

[12] *See generally* 12 U.S.C. §§ 1, 24, 81-95b (1964), *as amended* (Supp. IV, 1968).

[13] *See, e.g.*, Comptroller's Digest of Opinions ¶ 650(b):

"The purchase of investment securities under resale agreements permitting or requiring the purchasing national bank to sell the securities back to the seller are considered to be loan transactions and must be kept within the limitations provided in [12 U.S.C. § 84] and shown as loans on the books of the bank * * *"

[14] U.S. Dep't of Treasury, Comptroller's Manual for Nat'l Banks ¶ 1131 (1965). *See generally* Hackley, *Our Baffling Banking System*, 52 Va. L. Rev. 565, 598-599 (1966).

[15] 12 U.S.C. § 84(1964), *as amended* (Supp. IV, 1968).

a "selling" bank to statutory borrowing limitations.[16] Instead, the Comptroller determined that such transactions "in form as well as legal effect" were purchases and sales rather than lendings and borrowings.[17] Consequently, the Comptroller viewed taxpayer's "Refunding Bonds Purchased" account as an investment account and its agreements with dealers and other banks in connection with new-issue municipal bonds as sale-repurchase agreements.

In the court below the District Judge heard testimony from two of taxpayer's officers, a vice-president of one of the banks that engaged with taxpayer in transactions of the type here in issue, and officers of three bond dealers with whom taxpayer had dealt. As we construe the District Judge's opinion, the District Judge found, in addition to the stipulated and otherwise undisputed facts, that (1) successful bidders for municipal bonds sold their right to these bonds to taxpayer in exchange for taxpayer's assumption of their obligation to pay the issuing authority for them; (2) dealers were motivated to make these sales because of the "unique service" taxpayer could provide them in the marketing of bonds; (3) these dealers retained options to repurchase the bonds, but were not even tacitly obligated to exercise these options; (4) if dealers failed to exercise their options, taxpayer would absorb any loss or enjoy any gain on the subsequent sale of the bonds; (5) taxpayer entered these transac-

[16] 12 U.S.C. § 82 (1964), *as amended* (Supp. IV, 1968).

[17] *Hearings Before the Subcomm. on Bank Supervision and Insurance of the House Comm. on Banking and Currency and the House Comm. on Banking and Currency on H. R. 107 and H. R. 6885 With Respect to Consolidation of Bank Examining and Supervisory Functions*, 89th Cong., 1st Sess. 397 (1965).

tions to put idle funds to use as short-term investments; (6) that dealers invariably exercised their options to repurchase, even at a loss to themselves, reflected not an obligation to repurchase, but instead "sound business judgment based on the desire * * * to maintain [their] relationship with [taxpayer]"; (7) the language used by dealers in transacting with taxpayer was "trade language" signifying a sale-repurchase agreement; and (8) taxpayer and the dealers treated these transactions as sale-repurchases rather than as secured-loan transactions. On the basis of these findings, the District Court determined that

> "The rule of law established by court decisions when applied to the facts before this Court can result in no other conclusion than a decision that [taxpayer], in form and substance, was the owner of the municipal obligations and the interest income received by it was interest on the municipal obligations and therefore exempt to it under the provisions of section 103."

296 F. Supp. at 518.

We disagree with the District Court's conclusion for reasons we will point out in detail.

II.

This Court has not previously dealt with the problem of whether a bank paying an issuing authority for municipal bonds awarded to dealers and subsequently sold by these dealers to their customers is for tax purposes to be considered as the owner of the bonds while it holds them or as a

secured lender. The decided cases on this question announce various criteria for determining where ownership of the bonds resides in this situation. At most these tests of ownership are helpful, but we decline to regard them as "talismans of magical power," *Georgia Southern & F. Ry. Co. v. Atlantic Coast Line R. Co.*, 5 Cir., 1967, 373 F. 2d 493, 498, *cert. denied*, 389 U.S. 851, 88 S. Ct. 69 (1967); *accord*, *Tyler v. Tomlinson*, 5 Cir., 1969, 414 F. 2d 844, 848, and we consider no single criterion to be controlling. *See John Kelley Co. v. Commissioner*, 326 U.S. 521, 530, 66 S. Ct. 299, 304 (1946); *Tyler v. Tomlinson*, *supra*. Accordingly, we analyze this case in light of the statutory mandate that "Except as otherwise provided * * * gross income means all income from whatever source derived * * *" Int. Rev. Code of 1954, § 61(a).

Regarding the proper scope of our review, taxpayer contends that the question of ownership is one of fact, determined by the trial court in its favor, which should not be set aside unless clearly erroneous. Fed. R. Civ. P. 52(a). We recognize that the characterization of taxpayer's transactions with the dealers and other banks is at least partially a question of fact. Nevertheless,

> "* * * [t]he district court's finding on this ultimate issue * * * is not to be garrisoned by the clearly erroneous rule. Though it has factual underpinnings this ultimate issue is inherently a question of law. Obeisance to the clearly erroneous rule must yield when the facts are undisputed and we are called upon to reason and interpret. This is the law obligation of the court as distinguished from its fact finding duties * * *."

United States v. Winthrop, 5 Cir., 1969, . F. 2d [No. 26176, October 22]. *See also Bullock v. Tamiami Trail Tours, Inc.*, 5 Cir., 1959, 266 F. 2d 326, 330; *Thomas v. Commissioner*, 5 Cir., 1958, 254 F. 2d 233, 236. Since the basic facts in this case are stipulated or otherwise undisputed we are obliged to inquire into the ultimate conclusions reached by the District Court.

Only persons having the rights and incurring the risks that ownership of municipal bonds entails may treat the interest realized by them on the municipals they own as tax-exempt income under section 103(a) (1). Congress exempted interest on municipals from federal income taxation in part to aid states and their political subdivisions in borrowing from private investors the money needed to finance the business of government. *See, e.g., Holley v. United States*, 6 Cir., 1942, 124 F. 2d 909, 911. Section 103(a) (1) offers taxpayers an incentive to purchase municipals as investments by relieving them of the tax burden that would otherwise be imposed on the return they receive for putting their money to this particular use. *See* Int. Rev. Code of 1954, § 61(a) (4). To protect the revenue against "artful devices," the section 103(a) (1) income exclusion must be narrowly construed, *cf. Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260, 265, 78 S. Ct. 691, 694 (1958), and the substance of transactions rather than the form they take are controlling for federal tax purposes. *Id.; Gregory v. Helvering*, 293 U.S. 465, 55 S. Ct. 266 (1935). Therefore, for purposes of section 103(a) (1), ownership must have a genuine basis in reality. *Cf. Tyler v. Tomlinson*, 5 Cir., 1969, 414 F. 2d 844, 850.

In this case the Commissioner determined that taxpayer never acquired "ownership" of the municipal bonds involved in the transactions in issue. This determination was subject to a presumption of correctness in the court below which taxpayer had the burden of rebutting. *See, e. g., Cummings v. Commissioner*, 5 Cir., 1969, 410 F. 2d 675, 679. In light of the well-established principles stated above, we must interpret the undisputed facts here to determine whether taxpayer overcame this presumption.

We note first that more than the legal opinions and otherwise self-serving testimony of the trial court witnesses about their past intention to transfer "ownership" is required under the circumstances here to rebut the presumption that the Commissioner's determination was correct. *Cf. United States v. Smith*, 5 Cir., 1969, F. 2d [No. 25623, September 22]. Even if we were to accept the opinion testimony at face value, we would nevertheless be obliged to determine "* * * whether the intent and acts of these parties should be disregarded in characterizing [their] transactions[s] for federal tax purposes." *United States v. Snyder Brothers Company*, 5 Cir., 1966, 367 F. 2d 980, 982-983, *cert. denied*, 386 U.S. 956, 87 S. Ct. 1021 (1967) *citing Kraft Foods Company v. Commissioner*, 2 Cir., 1956, 232 F. 2d 118, 123. Similarly, that the Comptroller of the Currency has placed his imprimatur on the denomination of these transactions as sale-repurchases for banking regulation purposes is not conclusive that they were sale-repurchases for tax purposes.

The substance of the new-issue transactions involved in this case we find to have been as follows: (1) the successful

bidder-dealer for a new issue was entitled to delivery of the bonds upon payment of the bid price; (2) if payment was not made to the issuing authority according to the terms of sale, the dealer's good-faith deposit with the authority was subject to forfeiture; (3) the dealer, however, was not required to produce the purchase price of bonds coming into its inventory until after it had acquired funds received in payment for these bonds from its customers; because taxpayer paid the dealer's bid price to the issuing authority and retained the bonds, already in its possession at the direction of the issuing authority, until payment was transmitted from the dealer's customers; (4) taxpayer collected for itself the interest accruing on the bonds while it held them; (5) the dealer, regardless of whether it profited or lost upon sales to its customers, invariably caused taxpayer to be paid the bid price of the issue (a bid in which taxpayer played no part as to the purchase price the dealer agreed to pay if his bid was successful), adjusted for interest, and its handling charge and incidental expenses. As a result of transactions of this type, the distribution of new issues to the public was facilitated by means of the use of taxpayer's funds and the dealers' selling efforts. Taxpayer looked solely to the interest accruing on the bonds for its profit. The dealers profited if they could sell the bonds for more than their adjusted bids, but bore the risk that the bonds could not be sold for at least that much. In short, taxpayer was in effect a lender secured by collateral in its possession. Under these circumstances, we would be blinding

ourselves to reality if we did not see quite clearly that taxpayer's role here was that of a lending institution, making its funds available to bond dealers who bid successfully on new issues, retaining the bonds as collateral until the dealers had disposed of them to customers and reimbursed the bank, incurring no profits or risks due to market fluctuations, and being paid interest only for advance of its funds. We cannot indulge the fiction that the bank was the actual owner of the bonds under the undisputed facts, even if the parties to the transactions wish to term it so. How there could be a sale-repurchase transaction between the bank and a dealer when ordinarily a substantial portion of each bond issue was sold to the dealer's customers before the bonds were issued, and possession obtained by taxpayer, is hard to understand. Certainly the bank did not intervene as a "purchaser" of these bonds. The dealer exercised complete dominion over the bonds after they came into the bank's possession. He sold them at his pleasure, at prices he determined, and without reference to the bank, except that the proceeds were collected from the customer by the bank and applied to the dealer's account. Obviously the inventory of bonds was being held by the bank for the dealers and subject to their disposition. To us the bank was simply a lender of its funds to the dealers. For this service it was paid interest by the borrowing dealers. Taxpayer took only the risks of a lender in these transactions. We must, therefore, look beyond the forms and terms which the bank and the dealers attributed to these dealings to the real substance thereof. When we do, the conclusion is inescapable that tax-

payer was not entitled to the section 103(a) (1) income exclusion.

The only real risk that taxpayer incurred during the course of its transactions with the bond dealers was that the successful bidder for high-grade ("BAA" or above) bonds would, in a falling market, be either financially unable to take the bonds from taxpayer or be indifferent to the consequences of not taking them. Taxpayer enjoys a position of predominance in the distribution of municipal bond issues in Texas. Its refusal to provide its unique services to a bond dealer would bode ill for that dealer's business in the Texas bond market. The record shows clearly that dealers, so long as they desired to continue marketing new issues of Texas municipal bonds, insulated taxpayer from market fluctuations in the price of bonds that taxpayer held. The testimony of taxpayer's own witnesses establishes that bond dealers understood that taxpayer's continued participation with dealers in new-issue transactions depended upon the continued protection of taxpayer from the risk of loss in a falling market. Thus the basic risk of ownership of the bonds was incurred by the dealers.

The District Court considered two appellate decisions involving the tax effect of transactions between banks and bond dealers of the general type here in issue and concluded that one, *Commissioner v. Bank of California, Nat'l Ass'n*, 9 Cir., 1935, 80 F. 2d 389, *aff'g* B.T.A., 1934, 30 B.T.A. 556, was conclusive of this case, while the other, *First Nat'l Bank in Wichita v. Commissioner*, 10 Cir., 1932, 57 F. 2d 7, *aff'g* B.T.A., 1930, 19 B.T.A. 744, was distinguishable. Unlike the

District Court, we discern no rule of law in these cases which is controlling here.[12]

In *First Nat'l Bank in Wichita* the Board of Tax Appeals formulated the question for decison as follows:

> "The question here, as we view it, is not dependent upon who held the bare legal title to the bonds during the dates of sale and repurchase, but rather upon the broader issue as to whom, under the understanding between the bank and its customers, was entitled to receive, and who, as carried out, did receive the interest payments made by the issuing authorities of such bonds when collected and paid. * * *"

19 B.T.A. at 749. In *Bank of California* the Board also relied upon the manner in which the bank and the bond dealers treated the bond interest as support for its conclusion that the bank "owned" the bonds. 30 B.T.A. at 561. In our view, in the cited cases the Board placed undue emphasis on the intent and acts of the parties. As we said in *United States v. Snyder Brothers Company*, 5 Cir., 1966, 367 F. 2d 980, 982-983, the question with which courts must be concerned in cases such as this is whether the intent and acts of the par-

[12] Both *Bank of California*, decided in favor of the taxpayer, and *First Nat'l Bank in Wichita*, decided in favor of the Commissioner, were initially determined by the Board of Tax Appeals, an administrative board whose findings of fact were conclusive upon appellate courts at that time, "if the evidence was legally sufficient to sustain them and there was no irregularity in the proceedings." Phillips v. Commissioner, 283 U.S. 589, 600, 51 S. Ct. 608, 613 (1931). *See also* Revenue Act of 1926, § 1003(b), 44 Stat. 110; Revenue Act of 1924, § 900(g), 43 Stat. 253. Because judicial review of Board decisions was so circumscribed, we attach little significance to the action of the Circuit Courts in affirming the Board in these cases.

ties should be disregarded in characterizing their transactions for tax purposes. Under the circumstances here, taxpayer's "ownership" of these bonds was without substance; therefore, it was not entitled to treat bond interest earned as tax-exempt income.

To summarize, we hold that taxpayer failed to establish in the court below that it was entitled to treat the income received by it in the form of interest it collected on municipal bonds as excludable from its gross income under section 103(a) (1) of the Internal Revenue Code of 154. Section 103(a) (1) requires that "ownership" have a genuine basis in reality which is absent here when all the facts and circumstances are carefully examined. Accordingly, the judgment of the District Court is reversed. Since the District Judge did not consider taxpayer's claim for the allowance of an addition to its reserve for bad debts, the case is remanded for a ruling on this issue.

REVERSED AND REMANDED.

2. Judgment — Fifth Circuit

In the

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

October Term, 1969

No. 27301

D. C. Docket No. 67-38-A

AMERICAN NATIONAL BANK OF AUSTIN,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Western District of Texas.

Before GEWIN, THORNBERRY and AINSWORTH, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said Dis-

trict Court in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby remanded to the said District Court in accordance with the opinion of this Court.

It is further ordered that plaintiff-appellee pay to defendant-appellant, the costs on appeal to be taxed by the Clerk of this Court.

January 19,1970

Issued as Mandate:

3. Denial of Petition for Rehearing — Fifth Circuit

In the

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 27301

AMERICAN NATIONAL BANK OF AUSTIN,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Western District of Texas.

(February 18, 1970)

ON PETITION FOR REHEARING

Before GEWIN, THORNBERRY and AINSWORTH, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby DENIED.

APPENDIX B

1. Memorandum Opinion — District Court

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

AMERICAN NATIONAL BANK OF AUSTIN,

v.

UNITED STATES OF AMERICA,

Civil Action No. 67-38-A

MEMORANDUM AND ORDER

Plaintiff, the American National Bank of Austin, seeks to recover income tax and interest assessed against it in the amount of $788,031.77 for the taxable years 1962-1964. This case was tried before this Court without a jury.

During the years involved (1962-1964), the bank entered into transactions with certain bond dealers. In these transactions the bank would take delivery of municipal bonds either directly from the issuing authority for the account of the successful bidder-dealer or from one dealer for his

account where he purchased from another dealer. Payment for the bonds would be made entirely by the bank; not the dealer. The bank would send payment to the depository bank of the issuing authority. The bank retained possession of the bonds, which were payable to bearer.

A repurchase agreement was also part of the transaction between the bank and the dealer. Under this agreement, the bank agreed to give the dealer the right to repurchase the bonds from the bank at book value plus any accrued interest, sales expenses, and handling charges. The dealer was not obligated to buy the bonds, but merely had the first shot at them. If the dealer did not exercise his option to buy the bonds, the bank could sell them to any other buyer and the bank was to absorb any loss or gain on the sale.

During the time the bank held bonds purchased under this arrangement, it received the interest due on the bonds. In filing tax returns for the years in question, the bank claimed this interest was exempt under Sec. 103(a)(1) of the Internal Revenue Code of 1954 that excludes from gross income the interest on the bonds of any state or political subdivision. The District Director of Internal Revenue determined that this interest represented interest earned on loan transactions and ruled that the interest constituted taxable income. This ruling produced a deficiency in taxes, which the bank paid. After filing the pre-requisite claim for the refund of the taxes paid on this interest, the bank brought the instant action to recover the taxes paid on this interest.

The issue in this case is whether the bank was the true owner of the bonds and entitled to treat the bond interest collected as its own tax-exempt interest, or whether these transactions were merely loans under which the bond interest was the property of the dealers but collected by the bank as compensation for the use of its funds and thus taxable income to the bank.

In summary, the bank's position is that it was the true owner of the bonds in question and therefore entitled to exclude the interest from its taxable income. The Government's position is that these transactions were not sales, but rather loans, and that the bonds were merely used as security for the loans; hence, the interest belongs to the dealers, who are the only persons who can claim the tax-exempt character of this interest.

The Government correctly argues that substance should control over form and that the intent of the parties is an important factor. The court agrees with the government's statement of principle, but disagrees with its subsequent conclusion.

The only cases in point support the bank's position. In *First Nat'l Bank in Wichita*, 19 BTA 744 (1930), aff'd, 57 F. 2d 7 (9th Cir. 1932), cert. denied, 287 U.S. 636, the court found that the true relationship between the bank and its customers was that of a lender of money in consideration for the legal rate of interest payable on the amount ad-

vanced. However, the court in that case stated a test that favors the bank in the instant case:

> The question here, as we view it, is not dependent upon who held the bare legal title to the bonds during the dates of sale and repurchase, but rather upon the broader issue as to whom, under the understanding between the bank and its customer, was entitled to receive, and who, as carried out, did receive the interest payments made by the issuing authorities of such bonds when collected and paid.

Id. at 749.

In *Wichita*, the *dealer-customer* received the interest payments; in our case, however, the *bank* received the interest payments. It is clear that here all of the parties concerned — the bank, the dealers, and the issuing authorities — felt that the bank was entitled to receive the interest payments. Hence, *Wichita* seems to support not the Government but the bank.

Moreover, there are significant factual differences between *Wichita* and this case. In *Wichita*, the taxpayer-bank *advanced* to certain customers the face value of securities that were assigned to the bank, without any regard to their market value. In our case, the bank *bought* the bonds at market value. In both cases the repurchase agreement was basically the same: that the customer had the privilege of repurchasing the securities assigned to the bank at their original purchase price, and if the customer failed to exercise this privilege the bank could sell the securities in the market. However, unlike our case, the customer in *Wichita* was obli-

gated to make up any loss incurred by the bank on such sale. Moreover, the dealer in *Wichita* paid the bank a regular monthly payment, suggesting a lender-borrower relationship. The dealer's only payment in the instant case was for the entire cost of the bonds, plus the accrued interest and expenses. Also, whereas in *Wichita* the customer was allowed to substitute bonds of a like character and value, which further suggested a loan relationship, substitution was not present in this case.

The Government contends that the *Wichita* case supports its position. Although the Government admits that there was no *Wichita*-type agreement in this case by the dealers to reimburse the bank against any loss resulting from a subsequent sale of the bonds, the Government contends that the custom and practice of the parties in this case place this case essentially on the same footing as the *Wichita* case. However, the distinctions discussed in the preceding paragraphs require the conclusion that the Government's argument is without merit.

The Government also points out that the court in *Wichita* suggested that if the bank could demand repurchase of the bonds, the transaction would be a loan for the purposes of the legal lending limits. The Government goes on to argue that the parties in the instant case were under a similar agreement that the bank could demand repurchase of the bonds. In support of this contention, the Government submits that a letter from Mr. Houser, Vice-President of the bank, to a James C. Tucker Co. indicated that there was an agreement by Tucker to repurchase the bonds upon the

bank's request and that therefore it is reasonable to conclude that the same sort of agreement existed between the bank and the numerous other dealers involved in the transactions in question. It is clear to the court, however, that this Tucker letter did not represent the transactions before the court now. In the transactions reflected by this letter, the bank had agreed to purchase for a second time an issue that had been criticized by the bank examiners. The Tucker Co. and the bank agreed that if the bank examiners criticized these bonds again Tucker Co. would repurchase them. The bank examiner did criticize them again, and the bank requested that Tucker Co. repurchase them. There is no testimony in the record to indicate that this was anything but an unusual transaction. Moreover, there is abundant testimony that the dealers and the bank always considered that the dealers had a right to repurchase the bonds, but that the bank did not have the right to require the dealers to repurchase the bonds.

The other leading case in the area is *Bank of California, National Association v. Commissioner*, 30 BTA 556 (1934), *aff'd* 80 F. 2d 389 (9th Cir. 1935). There the bank acquired tax exempt securities from certain investment dealers and at the same time entered into a repurchase agreement with the dealers. The instant case is similar to that case in that in both the purchase price was based on market price; the interest received by the bank was the coupon interest, at the coupon rate, which it collected for its own account and treated as tax exempt; the interest was collected only when coupons became due (or on an accrued basis of unmatured

coupons when the securities were sold). Unlike our case, the agreements provided that the dealer was legally obligated to repurchase the securities upon tender by the bank. If the dealer refused, the bank could sell them, and the dealer would be obligated to absorb any loss incurred by the bank on the sale. In our case, the dealer merely had an option and not an obligation to repurchase and was not liable for any subsequent loss.

In Bank of California, the court, in following the Wichita test, determined that the bank was the owner of the securities and was entitled to the interest received therefrom. The interest thus received was therefore held to be tax exempt.

The Government attacks the Bank of California case on two grounds. First, the Government contends that the case was incorrectly decided because the court placed too much emphasis on the form of the transaction indicated by the documents. It is the opinion of this court that the case is good law. Second, the Government contends that the Bank of California case is clearly distinguishable from this case. The first distinction the Government offers is that whereas in Bank of California the bank did not have the authority to require the customer to repurchase the bonds, the bank in the instant case had the authority to require the dealers to repurchase the bonds. This point has been discussed and found lacking in merit. The Government points out that during the years in question no dealer failed to exercise his option. Hence, the second basis of distinction is the argument that in substance there was a tacit obligation to repurchase the bonds. However, the testimony shows that the

dealer could exercise his option at his discretion and that the bank could not have forced the dealer to buy the bonds. Moreover, two dealers in prior years did not exercise their options, which seems to corroborate the voluntary nature of the relationship.

From the fact that during the years in question no dealer failed to exercise his option, it does not follow that the dealers were required to exercise their option. The exercise of the option was not the result of legal obligation but the result of sound business judgment. If there was a profit to be made by the exercise of the option, the dealer, understandably wished to take that profit. Often, however, dealers repurchased bonds at a loss. The Government points to these instances as an indication that the dealers were under an agreement to repurchase and that there was a loan relationship. This repurchasing at a loss does not support the Government's conclusion. Rather, it is a reflection of sound business judgment based on the desire of the dealers to maintain this relationship with the American National Bank because the bank, due to its location in Austin, Texas, can save them money by reducing shipping, handling and communication costs.

Finally in the *Wichita* case, the court emphasized the fact that the transaction evolved to circumvent the legal loan limits. The bank here entered the bond business to make money, not to evade taxes or circumvent loan restrictions. This method of doing busines allowed the bank to put idle funds to work in short-term investments and indirectly

afforded the bank a real opportunity to be of service to the State of Texas and its political subdivisions.

Hence, the case law strongly supports this count's conclusion that the bank should prevail.

The basis of the decision in this case will be made clearer by discussing some of the arguments that the Government offers in support of its contention that the interest should be considered interest paid on a loan and not interest paid the true owners of the municipal bonds.

The Government contends that the bank paid the dealers less than market price for the bonds and that this constituted inadequacy of consideration, which suggests in turn that the bank was making a loan to the dealers rather than an actual purchase of bonds. This contention is based on the fact that often at the time the bank bought the bonds from the dealer, the dealer had already sold some of the bonds for a profit. Closer analysis of the business realities of the situation indicates that the government's contention is without merit. When the bank purchased bonds from the dealer, it purchased the entire issue at the price the dealer had agreed to pay the issuing authority, which of course, was at that time the market value. This price was still the market value when the bank, usually a very short time later, bought the bonds for that price from the dealer. The fact that the dealer had already sold some of the bonds for a profit merely reflects the fact that the specific investor is willing to pay higher prices to secure only the particular maturities he wishes for his portfolio, depending

on whether he wants bonds with short maturities or long maturities. The total price paid for the bonds sold individually to a number of investors, which reflects fair market value on the individual sales, is not representative of the fair market value on the sale of the entire issue.

The Government also contends that the language used by the dealer when he wanted the bank to buy bonds under this arrangement suggest that the bank was holding the bonds as security on a loan. Typical language used was, "Take (the bonds) up for our account"; "We would appreciate your accepting these bonds for our account, paying them their figures."

The bank's reply is persuasive. There was abundant testimony before this court that the dealers meant by this language that the bank was to purchase the bonds subject to the dealer's right to repurchase. This kind of language appears to be a recognized type of trade language with this commonly understood meaning. The Government insinuates that the almost identical testimony of several dealers to this effect suggests a lack of credibility. The more reasonable conclusion would seem to be that the meaning of this type language used in this kind of situation by dealers in bonds is so crystal clear that similarity in interpretation is inevitable.

Another aspect of the Government's form over substance argument is that these transactions, by allowing dealers to in effect keep larger "inventories" of bonds and by allowing the bank a short-term return on its money similar to a loan, were in substance loans. This contention is also not per-

suasive. The bonds in question were not part of the inventory of the dealers, nor were they carried on their records as inventory. The result of this kind of transaction between the bank and the dealer is merely that the dealer does not carry in inventory bonds he otherwise might carry if he financed them or paid for them with his own funds. But this does not change the substance of the transaction to a financing transaction. The dealer simply selected this method of doing business rather than buying them with his own money or borrowing money. But the Government cannot argue that since the dealer might have accomplished the result through one means, he necessarily is using that means to accomplish the end result. Both the Government and the taxpayer must accept the tax consequences of what has been done and not what could have been done.

Moreover, the record establishes that the bonds were sold by dealers to the bank, not because the dealer wanted to carry an inventory that he otherwise could not have carried, but because of the unique services provided by the bank. The bank's long experience in the trading of municipal bonds was stipulated in great detail; the bank's geographical location is an important reason for the bank's importance in this field because of its proximity to the part's state government related to municipal bonding. By selling bonds to the bank, dealers save great amounts of money by eliminating a duplication of shipping, bookkeeping, and communication costs.

The Government seems to base much of its argument on the notion that when a dealer gave the bank the right to

buy the bonds, the transaction was either an absolute sale with the bank having all incidents of ownership or a loan. Hence, the Government contends that the transactions must have been loans since the following facts clearly show that they were not absolute sales: the bank sold the bonds back to the dealers who exercised the repurchase agreement for no "profit"; the bank held the bonds until the dealer found a customer for them; the dealers were expected to and did offer the bonds for sale to their customers; and the bank never refused to convey bonds it held subject to a repurchase agreement when that dealer requested the bonds.

None of these facts, however, is inconsistent with the bank's ownership of the bonds subject to an option by the dealer to repurchase them. The government's "absolute sale or loan" argument is without merit because it ignores this perfectly legal kind of relationship. Also, as the bank points out, if a loan were created by the fact that the giver of an option expected the optionee to exercise that option by offering to sell the property covered by the option, many common option transactions would be turned into loans. Moreover, the fact that the bank made no "profit" in the sense of appreciation on the sale is irrelevant to the crucial issue in this case. The bank sought this kind of investment for the tax-exempt income. The transactions in question served this legitimate business purpose and gave the bank, if a dealer did not exercise his option, a possible opportunity to make a further profit by selling the bonds in the open market.

In this case, there has been no attempt to convert ordinary income into exempt income nor has there been any attempt to circumvent legal loan limit restrictions. The bank acquired for its own account municipal bonds. In deciding whether to purchase the bonds the bank made no credit investigation of dealers but investigated and looked only to the credit of the issuing authority. It paid with its own funds market value for the bonds. The interest received by the bank was the coupon interest, at the coupon rate. Interest was received only when coupons became due on the sale of a security to the extent of interest accrued on unmatured coupons. Dealers, while having a preferential right to purchase the securities, had no legal obligation to purchase the securities. In the event a dealer did not elect to exercise his preferential right to purchase the securities, a loss or gain on a sale by the bank in the market did not give rise to an obligation of the dealer to make up the loss nor a right to the surplus received. The bank and each dealer at all times treated the securities, the coupons and the interest received as property of the bank, who carried as assets the bonds on its financial reports and call statements. Dealers did not show the bonds owned by the bank as assets on their financial statements. The purchasing bank in every respect considered, and reflected on its books, that it purchases the bonds from the bank and then owned the bonds. In making loans, the bank almost always required that the borrower maintain with it a banking relationship and the borrower was normally required to maintain a compensating balance of at least 10% of the loan. Yet,

the bank bought bonds from and sold bonds to dealers without reference to any banking relationship and without any request or requirement therefor. The bank as a national bank, could not, under regulations of the Comptroller of the Currency, make loans unless they were evidenced by a note or some other kind of debt instrument. No note or other instrument evidencing loans from the bank to dealers was executed. The bank in numerous instances owned bonds on which the aggregate option price would range from 10 to 20 times the loan limit of a loan to the dealer. During the years in question the trading by the bank in municipals was subjected to the scrutiny of the Comptroller of the Currency and the Comptroller ruled that the bonds reflected in the Bank's trading account are the property of the bank.

The rule of law established by court decisions when applied to the facts before this Court can result in no other conclusion than a decision that the bank, in form and substance, was the owner of the municipal obligations and the interest income received by it was interest on the municipal obligations and therefore exempt to it under the provisions of section 103.

It is therefore ORDERED, ADJUDGED, AND DECREED that the United States of America make the necessary adjustments with the taxpayer to allow him to exclude from his gross income for the years in question the interest from the coupons involved in these transactions and to allow the bank a refund on its investment credit in the sum of $6,292.90,

which, as the Court understands it, is not contested by the Government.

Signed at Austin, Texas, this 11th day of October, 1968.

/s/ JACK ROBERTS

Jack Roberts
United States District Judge

2. Judgment — District Court

In the

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

AMERICAN NATIONAL BANK OF AUSTIN,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

Civil Action No. 67-38-A

JUDGMENT

This action came on for trial before the Court, Honorable Jack Roberts, District Judge, presiding, on July 22 and July 23, 1968, and the issues having been duly tried, and the Court on October 11, 1968 having issued its Memorandum Findings of Fact and Conclusions of Law and Order in favor of plaintiff, American National Bank of Austin, and against defendant, United States of America,

It is Ordered and Adjudged that plaintiff, American National Bank of Austin, recover of defendant, United States

of America, the sum of $788,382.44, with interest thereon as provided by law.

Entered at Austin, Texas, this 22nd day of November, 1968.

/s/ JACK ROBERTS
United States District Judge

Approved as to form:

/s/ BUFORD P. BERRY
Attorney for Plaintiff

/s/ STANLEY F. KRYSA
Attorney for Defendant

In the

Supreme Court of the United States

OCTOBER TERM, 1969

No.

AMERICAN NATIONAL BANK OF AUSTIN,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of May, 1970, three copies of the Petition for a Writ of Certiorari were mailed, postage prepaid, to Mr. Johnnie M. Walters, Assistant Attorney General, Tax Division, United States Department of Justice, Washington, D. C. 20530. I further certify that all parties required to be served have been served.

/s/ JOHN W. RUTLAND, JR.

John W. Rutland, Jr.
2300 Republic National Bank Building,
Dallas, Texas 75201,
Counsel for Petitioner.